
Tax Benefits of Aircraft Ownership

AOPA Aviation Summit 2010

A Presentation Designed for
Aircraft Owners and Operators



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IRS Required Disclaimer

Important Disclaimer pursuant to IRS Circular 230

Note: This memorandum and supplementary information represents a general overview of tax developments and should not be relied upon without an independent, professional analysis of how any of these provisions may apply to a specific situation.

Disclaimer: Any tax advice contained in this correspondence was not intended or written to be used, and cannot be used, by the recipient for the purpose of avoiding penalties that may be imposed under the Internal Revenue Code or applicable state or local tax law provisions.

→ If you use your aircraft for business – you are entitled to tax deductions related to its use

→ How effective the deductions are in generating actual tax savings depends on the nature of use, the structure of ownership and operations, and proper use of tax elections

A Business Perspective

- You are not in the 100% income tax bracket – each dollar you spend saves \$.40 – the airplane must help you make money – not just generate tax savings
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An Entrepreneurial Company

→ An idea

→ A marketing plan

→ Need for cash

Tax Savings as a Source of Capital

- How tax savings helped our company grow from a Cessna 182 to an Embraer Phenom 100 in 17 short years
-

Our Practice

- ✈ The private fleet program serves tax and regulatory needs of businesses transporting persons or property in interstate commerce
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Indianapolis + 100 Miles Service Area Serviced by Automobile

- Limited success in Indianapolis proper
 - But engaged large grocer in Cincinnati – who introduced us to a large baker
-

Client Needs

- The grocer had on site visit needs in Louisville, Nashville, Dallas, and Hutchinson, Kansas
 - Too far to drive – no commercial service
 - Enter the C182
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Employee Growth

- The baker secured for us a speaking invitation at a bakery convention
 - Soon bakeries in Columbus, OH, Youngstown, OH, Erie, PA dropping off staff with employee shuttle
 - Enter the Cherokee 6
-

Geographical Growth

- Work with truck rental companies in Reading, PA and Miami, FL and aircraft manufacturers in Kansas, Texas and Georgia leads to work throughout the country
 - Discover ice then Seneca & MU2
-

Leverage Efficiency

- Work expands in California, Canada, and South America
 - Welcome Phenom 100
-

Business Opportunity Comes First

- But tax depreciation creates cash flow necessary to acquire an aircraft



General Rule 50% Business Use – 5 Year MACRS

Mid-Year

→ 20%

→ 32%

→ 19%

→ 12%

→ 12%

→ 5%

Mid-Quarter

5%

38%

23%

19%

11%

9%

With a 40 year economic life

For 2010 and 2011 – Enhanced Expensing

- Available for new or used aircraft
 - Expense maximum \$500,000
 - Available to small taxpayers –
maximum investment \$2,500,000
 - Limited to taxable income
-

Bonus Depreciation for 2010

- 50% of cost of new aircraft, or new improvements to used aircraft
 - Unlimited in amount – may create loss subject to carryback
-

MACRS Tax Savings Cash Flow on \$1,000,000 Aircraft

	<u>Deduction</u>	<u>Tax Savings @40%</u>	<u>After Tax Payments</u>	<u>Cumulative Net Investment</u>
1	\$200,000	\$ 80,000	\$172,000	\$92,000
2	\$320,000	\$128,000	\$ 53,000	\$17,000
3	\$190,000	\$ 76,000	\$ 54,000	<\$ 5,000>
4	\$120,000	\$ 48,000	\$ 54,000	\$ 1,000
5	\$120,000	\$ 48,000	\$ 55,000	\$ 8,000
6	\$ 50,000	\$ 20,000	\$ 56,000	\$44,000

July 1st, 15% down, 6 % int., 20 yr am

Bonus and Enhanced Expensing Tax Savings Cash Flow

	<u>Deduction</u>	<u>Tax Savings @40%</u>	<u>After Tax Payments</u>	<u>Cumulative Net Investment</u>
1	\$800,000	\$320,000	\$172,000	<\$148,000>
2	\$ 80,000	\$ 32,000	\$ 53,000	<\$127,000>
3	\$ 48,000	\$ 19,000	\$ 54,000	<\$ 92,000>
4	\$ 30,000	\$ 12,000	\$ 54,000	<\$ 50,000>
5	\$ 30,000	\$ 12,000	\$ 55,000	<\$ 7,000>
6	\$ 12,000	\$ 5,000	\$ 56,000	\$ 44,000

July 1st, 15% down, 6 % int., 20 yr am

It's a Partnership With the U.S. Treasury

- The airplane helps you increase gross income
 - The IRC allows deductions
 - Everyone wins
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The FARs Do Not Prohibit Incidental Business Use

- ➔ It's transportation for hire that is limited – not use of the aircraft furthering business - or dry leasing
-

The IRC Does Not Limit Deductions for Business Use of the Aircraft

- But it must be ordinary,
necessary, and reasonable in
amount and used in a trade or
business



The Principal Tax Benefits Include

- Accelerated depreciation over economic depreciation
 - Tax deductible training
 - Tax favored compensation for personal non-entertainment use
 - Deduction of fixed cost
 - No imputed income for loving your job
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Training is Deductible Provided it Doesn't Prepare You for New Business

- Commercial or ATP licenses not deductible but private instrument, multi-engine are, as well as proficiency flying
-

The Fringe Benefit of Aircraft Use

- SIFL – a formula method derived from commercial rates adjusted for aircraft size
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How SIFL Works

- A charge designed to tax the benefit of aircraft usage based on the cost of commercial travel.
 - Varies based on:
 - Classification of employee
 - Gross take-off weight of aircraft
 - Length of trip
 - Number of landings
-

A SIFL Estimate

An Estimated Charge Based on an

Average 1 ½ Leg

		<u>Per M.</u>	<u>Per Hour</u>
< 6,000 lbs.	Meridian	\$.1250	\$ 25
6-10,000 lbs.	TBM 700	\$.2500	\$ 60
10-25,000 lbs.	CJ1	\$.6000	\$200
>25,000 lbs.	G550	\$.8000	\$425

Personal Entertainment Use May Limit Deductions

- What is entertainment?
 - Impact of payments
 - Planning is essential
 - Reliance on proposed regulations
-

Fixed Cost Allocation When Personal Entertainment Use

- Proposed regulations provide opportunities to avoid proportionate disallowance
-

Structure Matters

- Most aircraft held in special purpose entities
 - Business reasons, ownership, confidentiality, disposition
 - Liability protection
 - Ease of FAA compliance
 - Sales tax deferral
 - Income tax benefits – an entity has no personal use
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Income Tax Structuring Pitfalls

- Hobby loss classification
- Passive activity limitations



Hobby Loss Classification

- For fun or profit?
 - An “honest expectation of economic profit from an activity”
-

What is an Activity?

- Includes interdependent undertakings if elected by the taxpayer; but no guidance provided on how to elect to group or separate
-

An Airplane is Generally a Tool, not a Profit Center

→ Will Generally want to group

Passive Activity Classification

Isolates Deductions to Offset Passive Income

- Must materially participate and not be a rental activity



Passive Activity Grouping Guidance by Rev Proc 2010-13

- Effective for years beginning after 1/25/10 statement in original return of entities to be grouped as a single activity
 - No election is an election to separate
-

Can Trade Business Airplanes Tax Free, but not Business for Personal

- Like-kind exchange rules apply for federal income tax purposes and in many state for sales tax purposes
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Can Convert LLC Airplane to Personal Tax Free After Fully Depreciated

- But during depreciable life business percentages must exceed 50%
 - Eventual sale will result in ordinary income even after personal conversion
-

Recordkeeping is Vital

- Why you expected economic profit
 - Your investment of time
 - Account for the business purpose of each flight hour
-

State Tax Planning

- States with property tax
 - Assessment date presence or, more than 50% of time
 - Or declared home base
-

Sales and Use Tax Planning

- Where you buy, or
 - Where you are based;
 - But not generally where formed;
 - But may be where you fly
-

Where You buy

- Unless exempt – its taxable
 - Popular exemptions – fly away, casual sale, sale for resale
 - May require exemption certificate
-

Where You Are Based

- If it would be subject to sales tax if purchased; subject to use tax if based
 - Popular exemptions, casual sale, sale for resale
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Where You Fly

- If you visit often, you may get trapped
 - Generally, but not always, credit for tax at home
 - Often extortion tactics – lien now, argue later
 - Suppress your N number – level the playing field
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